

## Is the Franco-German leadership of Europe doomed?

A weakening Germany and a continuously weak France cast doubts on the revival of the Franco-German leadership, which had actually waned long ago. A column by Charles Wyplosz.

CHARLES WYPLOSZ



«The emergence of the Hansa League is an early signal of things to come; never before have we seen resistance from the smaller countries.»

France and Germany are the largest members of the European Union. As such they wield a strong influence on decisions and their economic performances affect the whole of the Union. Once they agree on a decision, it is almost always accepted. Yet, the Franco-German leadership is less automatic than it used to be before the Union was expanded to include 28 (27 after Brexit) countries. In addition, the mismanagement of the Eurozone debt crisis has instilled doubts about this leadership, which may be further eroded by the challenges that both countries are now facing.

The Eurozone debt crisis should never have happened. It showed that the Stability and Growth Pact had failed to keep public debts in check in a number of countries. This was made apparent on several occasions, including already in 2004 when, facing «excessive deficit», France and Germany managed to suspend the pact. When the crisis erupted, there was no process in place to deal with a situation that had never been anticipated. Countless summit meetings were called to develop a response. For many months, the responses were inadequate and the crisis spread from one country to another, in spite of the declared intention to prevent contagion. Massive amounts of money were lent to the crisis countries, which increased their already dangerous indebtedness. The infamous stroll by the sea of Angela Merkel and Nicolas Sarkozy ended with the Deauville declaration that the Greek debt would be partially defaulted upon, which predictably aggravated financial instability.

Importantly, it demonstrated all the limitations of the Franco-German leadership: the leaders were poorly prepared and seriously misinformed, they failed to consult with the other governments and, yet, they were able to create a *fait accompli*. The conditions imposed on the crisis countries were often misguided and created deep resentment. Disagreements between both governments ran deep and their agreements were mostly tactical, while a well-informed strategic vision would have made it possible to stop the rot when it appeared in Greece, with less costs imposed on the Greek population.

### German exports under pressure

The election of Emmanuel Macron was seen as a historical opportunity to «fix Europe». Unfortunately, the French President chose to recycle the old French vision of a more centralized Europe, which had been repeatedly rejected. His proposals were announced without checking with Germany – or without clear support from a politically-diminished Chancellor – and the other countries.

Predictably, the German reaction was tepid. French efforts to build up a Eurozone budget were met with resistance. After long negotiations, Germany only agreed to a symbolic budget, which was, and remains opposed by a coalition of the Netherlands and the Northern European countries, the so-called Hansa League. An occasion has been missed.

In fact, the erosion of the Franco-German leadership is deeper than just mistakes and disagreements. Both countries are feeble, economically and politically. Start with Germany. Its stellar economic performance after 2010 created the impression of a long-lasting resurgence. Driven by exports to Asia, China in particular, its success rested on the apparently irresistible appeal of its luxury cars, sophisticated production equipment and high-end metallurgy, produced relatively cheaply in networks that combined high-tech firms from the *Mittelstand* and lower-paid workers in Central and Eastern Europe. Thanks to the Hartz labor reforms of the early 2000s, the economy operated at full employment and, yet, wages remained reasonably stable.

That was then. The marked slowdown in China has now hit exports and it seems that they will not recover. Indeed, China has gradually climbed the quality ladder and wages have risen in Central and Eastern Europe. Meanwhile, the large banks that traditionally financed industry have moved very slowly to adjust from the financial crisis, partly because the government has done its utmost to protect them. They are now ill-placed to foster the needed restructuring. Besides, during her long tenure, Chancellor Merkel has studiously avoided serious reforms, except for the establishment of a minimum wage that is not helping at a time when the car industry is globally facing a deep upheaval.

### France stuck in inability to reform

France has been largely unreformed for well over three decades. Its public service is bloated and inefficient, with a spectacular failure of the education system. The labor market is rigid and unemployment has rarely dipped below 8%. Macron has been elected on a program that was based on a frank and lucid diagnosis of France's woes and on courageous, if limited promises of reforms.

Many have been enacted during the first year of his presidency, until he was hit mid-air by the populist revolt of the «yellow vests». The early response to that revolt was to provide subsidies to lower-paid workers, but these subsidies are not financed by lower spending or higher taxes, they simply increase the budget deficit. Having lost what looked like a magic touch, the ability to push through long-resisted reforms, he now is unlikely to be able to carry out the rest of his program. The most plausible scenario is that France will remain largely unreformed and prone to continuous deficits.

Under this scenario, economic growth will remain slow, unemployment will not decline much, and France will return to the climate of pessimism that propelled Macron to the presidency. The political consequences would be worrisome.

A weakening Germany and a continuously weak France cast doubts on the revival of the Franco-German leadership, which had actually waned long ago. During the debt crisis, it was more apparent than real. Chancellor Merkel took most decisions but was careful to enlist President Sarkozy's support. «Merkozy», as the unspoken agreement was called, was a convenient illusion that served both leaders' political interests: Merkel had a free hand and Sarkozy could pretend to share power. The election of Hollande, whom Merkel did not even bother to associate to her decisions, laid bare her total dominance. Nowadays, an enfeebled Germany is unable to lead without France but Germany's appreciation of Macron is fast deemng.

The implications could be far-reaching for Europe, but also beyond. For a long time, the German attachment to a social market economy and the French desire to build a globally powerful Europe resulted in compromises that were usually reasonable. When they were not, the UK would step in with the tacit support of many Northern European countries. Brexit removes this balancing act. The emergence of the Hansa League is an early signal of things to come; never before have we seen resistance from the smaller countries. To make matters worse, many Central and East European countries are run by illiberal Euro-skeptic governments, and they are reinforced by the political turn in Italy. The best outcome could be a passive management of Europe, the worst outcome being growing cracks leading to outright mismanagement. At a time when the world is being reshaped by Trump's haphazard initiatives and China's ambitions, a strong Europe would be most needed. Too bad.

### About the author

Charles Wyplosz is Professor of International Economics at the Graduate Institute in Geneva and Director of the International Center of Monetary and Banking Studies.